GEYSERS GEOTHERMAL CO.

IBLA 85-902 Decided December 16, 1987

Appeal from a decision of the Director, Minerals Management Service (MMS-83-0002-GEO), affirming an order that effluent disposal payments were to be included in the value basis for determining the royalty to be paid for geothermal steam produced under Geothermal Lease Nos. CA-956A, CA-958, and CA-1862.

Affirmed.

1. Geothermal Leases: Royalties

> In determining the royalty due to the United States pursuant to a geothermal resource lease, it is proper for the Minerals Management Service to include, as part of the value basis for computing royalty, the amounts the purchasers of the steam have paid to the lessee for effluent disposal. Such payments are in the nature of a reimbursement of expenses, are properly viewed as part of the total consideration accruing to the lessee from the sale of the geothermal resources, and are a part of the geothermal production subject to royalty as required by 30 CFR 206.300.

APPEARANCES: George M. Paulson, Jr., Esq., Denver, Colorado, for appellant; Peter J. Schaumberg, Esq., Office of the Solicitor, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE MULLEN

Geysers Geothermal Company (GGC), successor to Aminoil USA, Inc., (Aminoil) 1/ has appealed from a decision of the Director, Minerals Management

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1/ GGC explains its current relationship to these leases in its statement of reasons (SOR), stating:

"Aminoil USA, Inc. ("Aminoil") was succeeded by Aminoil Inc. who in turn spun off the geothermal business which it had to Geysers Geothermal Company ("GGC"), a Delaware corporation, on August 1, 1984. Subsequently, all of the stock of GGC was sold to Phillips Oil Company who in turn sold all of such stock effective October 27, 1984 to Phillips Petroleum Company. GGC is now a wholly-owned subsidiary of Phillips Petroleum Company."
(SOR at 1).

Service (MMS), dated April 22, 1985, affirming a December 17, 1981, order of the Geothermal Accountant, Menlo Park, California, instructing GGC to include an additional 0.5 mill-per-kilowatt-hours (KWH) of net output in the royalty value basis for geothermal steam produced by Aminoil and sold to the Pacific Gas and Electric Company (PG&E), and the Sacramento Municipal Utility District (SMUD). 2/

The Geothermal Accountant ordered Aminoil to recalculate the royalty value for geothermal steam produced under lease Nos. CA-956A, CA-958, and CA-1862, to include the effluent disposal payments made by PG&E from the date of first production.

The Director's decision described the background for this accounting order, stating in pertinent part:

> The leases were issued under authority of the Geothermal Steam Act of 1970, 30 U.S.C. 1001 et seq., and are subject to the product valuation regulations set forth in 30 CFR Part 206. See 30 U.S.C. 1023. Section 206.300 of the regulations (formerly 30 CFR 270.62, redesignated at 48 FR 35641, August 5, 1983) provides that the value of the production for purposes of computing royalty shall be the reasonable value of the produced energy and by-products as determined by the Supervisor. Paragraph (b) of section 206.300 states that:
>
> > Under no circumstances shall the value of any geothermal production for the purposes of computing royalties be less than:
> >
> > (1) The total consideration accruing to the lessee from the sale thereof * * *.
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> Section 3(c)(1) of the leases provides for payment of a percentage royalty on the "* * * amount or value of steam, or any other form of heat or other associated energy produced, * * *." Section 4 of the leases states in relevant part:
>
> > It is expressly understood that the Secretary may establish the values and minimum values of geothermal resources to compute royalties in accordance with the applicable regulations. * * *

2/ Appellant states in its appeal that it has also paid royalties on amounts paid it by SMUD for effluent disposal after the SMUD electric generating plant began to operate in October 1983. Appellant states it paid these amounts under protest although they were not included in the Geothermal Accountant's original order of December 1981.

> Section 9 of the contract executed by Signal Oil and Gas Company (Aminoil's predecessor in interest) and PG&E for the sale of geothermal steam produced under the leases sets forth the terms of payment and provides in paragraph (c):
>
> > As consideration to Producer for disposing of the liquid effluent in accordance with paragraph 7(a) hereof, as long as Producer is so disposing of said effluent PGandE shall pay to Producer an amount equal to 0.5 mill per kilowatt hour of net output.

The Director rejected Aminoil's argument that the 0.5 mill-per-KWH of net output Aminoil received from PG&E was an unrelated payment for this service, and not additional consideration for the steam delivered under the contract. The Director also rejected Aminoil's argument that the effluent material was not a substance produced by Aminoil as the Government's lessee and delivered to PG&E as purchasers, but was spent fluid without commercial value and the payment for disposal of the fluid should not have been figured in the total royalty value.

The Director found that paragraph 7 of the sales contract requires Aminoil to dispose of the effluent "at its sole risk and expense" and that irrespective of any private arrangements for reimbursement or payment for effluent disposal costs, the lessee has ultimate responsibility for effluent disposal under the Federal leases and regulations. Accordingly, he stated:

> If PG&E were to dispose of the effluent, it would be assuming a responsibility of the lessee. Since the lessee is responsible for effluent disposal, the payment involved here is akin to a "reimbursed expense" that must be included in royalty computations under the principles established in Wheless Drilling Company, 80 I.D. 599, 13 IBLA 21 (1973), and Hoover & Bracken Energies, Inc. v. U.S. Department of the Interior, 723 F.2d 1488 (10th Cir. 1983).

He concluded that the payment for effluent disposal is reasonably included as a part of the "total consideration" under the lease agreement and 30 CFR 206.300(b).

Appellant reiterates essentially the same arguments made to the Director, MMS, that the payment is for disposal of a waste substance. Appellant argues that it does not sell the effluent but instead receives payment for disposing of the liquid effluent for PG&E and for disposing of waste water for SMUD. Appellant contends this payment is properly characterized as payment for service rendered and should not be characterized as additional consideration for steam delivered or payment for extracted energy (Statement of Reasons (SOR) at 3-5, 6). Appellant asserts the effluent material is "spent fluid" from which all valuable energy has been extracted, has no commercial value, and carries considerable burden and risk of disposal. However, it

states: "GGC is willing to undertake this burden of disposing of this worthless liquid for the service fees set out in the respective contracts as it is a necessary operation to effect the sale of energy" (SOR at 5).

Appellant asserts the leases call for a payment of royalty only on the value of steam, other forms of heat, or associated energy produced that is reasonably susceptible to sale or utilization by the lessee. Appellant contends that under section 1(e) of the lease, upon obtaining approval of a plan for reinjection, it has the right to reinject waste products without paying royalties. 3/

MMS has responded, noting that GGC does not dispute its obligation to pay royalty based on a value no less than the total consideration accruing to it from the sale of geothermal resources. See 30 CFR 206.300(b)(1), and Marathon Oil Co. v. United States, 604 F. Supp. 1375 (D. Alaska 1985). MMS reaffirms its position that payments by energy purchasers for effluent disposal are in the nature of reimbursed expenses which are part of the total consideration to GGC. It contends that GGC is not entitled to a reduction in royalty value for the cost of rendering the product marketable, and notes that the costs are similar to the cost of making oil and gas acceptable to a purchaser, citing California Co. v. Udall, 296 F.2d 384 (D.C. Cir. 1961).

MMS also refers to section (6) of the leases as being in support of its position, stating:

> The effect of this provision is that it recognizes that effluent disposal is a part of the operation of recovering the geothermal resource and that hence any payment therefore necessarily is part of the total consideration for the resource. Indeed, reinjection is permitted only when it is part of the overall operation to recover geothermal resources. [Emphasis in original.]

(Answer at 3).

[1] The Geothermal Steam Act of 1970, 30 U.S.C. § 1004(a) (1982), requires that geothermal lessees pay a royalty of not less than 10 percentum or more than 15 percentum of the value of steam or any other form of heat or energy derived from production under the lease and sold or utilized by the lessee or reasonably susceptible to sale or utilization by the lessee. Pursuant to the Secretarial authority to prescribe such rules and regulations

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3/ Section 1(e) of the leases provides:

"The right, without the payment of royalties hereunder, to reinject into the leased lands geothermal resources and condensates to the extent that such resources and condensates are not utilized, but their reinjection is necessary for operations under this lease in the recovering or processing of geothermal resources. If the Lessee, pursuant to any approved plan, disposes of the unusable brine and produced waste products into underlying formations, he may do so without the payment of royalties."

as he may deem appropriate to carry out the provisions of the Act, 30 U.S.C. § 1023 (1982), the Department promulgated 30 CFR 206.300. This regulation sets forth the guidelines for determining the value of geothermal production when computing royalties, and provides in pertinent part:

> (a) The value of geothermal production from the leased premises for the purpose of computing royalties shall be the reasonable value of the energy and the byproducts attributable to the lease as determined by the Supervisor. In determining the reasonable value of the energy and the byproducts the Supervisor shall consider:
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> (1) The highest price paid for a majority of the production of like quality in the same field or area;
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> (2) The total consideration accruing to the lessee from any disposition of the geothermal production;
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> (3) The value of the geothermal production used by the lessee;
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> (4) The value and cost of alternate available energy sources and byproducts;
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> (5) The cost of exploration and production, exclusive of taxes;
>
> (6) The economic value of the resource in terms of its ultimate utilization;
>
> (7) Production agreements between producer and purchaser; and
>
> (8) Any other matters which he may consider relevant.
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> (b) Under no circumstances shall the value of any geothermal production for the purposes of computing royalties be less than:
>
> (1) The total consideration accruing to the lessee from the sale thereof in cases where geothermal resources are sold by the lessee to another party. [Emphasis added.]

In addition, these requirements are embodied in the royalty clause of the lease at 3(c)(1), which provides: "(1) A royalty of 12 1/2 percent on the amount or value of steam, or any other form of heat or other associated energy produced, processed, removed, sold, or utilized from this lease or reasonably susceptible to sale or utilization by the Lessee." Moreover, section 4 of the leases (Payments), which acknowledges and reiterates the Secretary's authority to set the basis for royalties, states in pertinent part:

> Sec. 4. PAYMENTS - It is expressly understood that the Secretary may establish the values and minimum values of geothermal resources to compute royalties in accordance with the applicable regulations. Unless otherwise directed by the Secretary, all payments to the Lessor will be made as required by the regulations.

We have reviewed appellant's arguments in light of the governing regulations and lease terms, and agree with the Director, MMS, that the payments described as being for the effluent disposal are properly considered part of the total consideration accruing to the lessee from the sale of the geothermal resources. Appellant has advanced nothing with this appeal to persuade us that the reimbursement of expenses provided for in the sales contract are not a part of the total consideration accruing to the lessee from disposition of geothermal production.

The Department has followed a similar course of action when determining the value basis for oil and gas royalties. See Marathon Oil Co. v. United States, 604 F. Supp. 1375 (D. Alaska 1985). For royalty purposes an oil and gas lessee is not entitled to deduct the costs of making the product marketable, i.e., those costs typically incurred which are necessary to make the oil and gas acceptable to the purchaser, from the total compensation it receives when calculating the royalty basis. California Co. v. Udall, 296 F.2d 384 (D.C. Cir. 1961). Nondeductible reimbursements include reimbursement for services such as compression and the removal of impurities (Answer at 2). The same rationale holds true for our consideration of the payments for effluent disposal in the case at hand. In order for appellant to sell this geothermal resource, i.e., the heat contained in its well product, it must contemplate the disposal of the waste by-product. In this case that by-product is spent liquids.

Appellant has also failed to distinguish the cases which uphold the proposition that total consideration includes reimbursed expenses. Wheless Drilling Co., 13 IBLA 21, 80 I.D. 599 (1973); Hoover & Bracken Energies, Inc. v. U.S. Department of the Interior, 723 F.2d 1488 (10th Cir. 1983). In that the royalty payable is an overriding royalty, rather than a net-profits royalty, the cost of production is not a deductible item. We find these cases are dispositive when considering whether payments to appellant for effluent disposal are in the nature of reimbursed expenses which must be treated as part of the total consideration accruing to GGC.

Appellant admits that under the terms of the lease agreement it carries the primary responsibility for effluent disposal even if it were not reimbursed for this activity. Appellant also admits that effluent disposal is a necessary service provided by the lessee in order to make the resource marketable: "GGC is willing to undertake this burden of disposing of this worthless liquid for the service fees that are stipulated in the respective contracts as it is a necessary operation to effect the sale of energy" (SOR at 5 (emphasis added)).

Accordingly, the payments are properly included as a part of the total consideration accruing to the lessee from the sale of geothermal resources. Appellant must therefore include these payments in the total consideration accruing to it, and calculate royalties after including this amount in the royalty basis.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

R. W. Mullen
Administrative Judge

We concur:

James L. Burski
Administrative Judge

Bruce R. Harris
Administrative Judge